

PART D PAYMENT SYSTEM

payment**basics**

Revised:
October 2019

In 2006, Medicare began a voluntary outpatient drug benefit known as Part D. A combination of stand-alone prescription drug plans (PDPs) and Medicare Advantage (MA)–Prescription Drug plans (MA–PDs) delivers the benefit. In each of 34 geographic regions, plans compete for enrollees on the basis of annual premiums, benefit structures, specific drug therapies covered, pharmacy networks, and quality of services. Plans bear some risk for their enrollees' drug spending. Overall, Medicare subsidizes premiums by about 75 percent and provides additional subsidies for beneficiaries who have low levels of income and assets.¹ Medicare's payments to plans are determined through a competitive bidding process, and enrollee premiums are tied to plan bids.

The drug benefit

The standard 2020 benefit will include:

- a \$435 deductible;
- coverage for 75 percent of allowable drug expenses up to an initial benefit limit of \$4,020;
- a \$6,350 catastrophic limit on true out-of-pocket (OOP) spending²; and
- about 5 percent coinsurance for drug spending above the OOP threshold (Figure 1).

Prior to 2011, enrollees with standard benefits were responsible for paying the full cost of drug spending between the initial benefit limit and the out-of-pocket threshold. The Patient Protection and Affordable Care Act of 2010 (PPACA) directed CMS to phase out this coverage gap between 2011 and 2020. The Bipartisan Budget Act (BBA) of 2018 made changes that further reduced cost sharing for brand-name drugs in 2019.³ Under the standard benefit, cost sharing for both brand and generic drugs has been reduced each year, and in 2020 beneficiaries will

pay 25 percent cost sharing for all drugs until they reach the OOP threshold.

Plans can and often do offer alternative coverage structures. For example, a plan can offer a deductible lower than \$435, or use tiered copayments rather than coinsurance—provided that the alternative benefit meets certain tests of actuarial equivalence. Also, plans may offer additional drug coverage that supplements the standard benefit. Medicare payments to plans do not subsidize such supplemental coverage.

Under Part D, Medicare provides primary drug coverage for individuals who are dually eligible for Medicare and Medicaid. Dually eligible individuals with incomes up to 100 percent of poverty have no deductibles, nominal copays, and no coverage gap. Beneficiaries who do not qualify for full Medicaid benefits but whose incomes are below 150 percent of poverty and who meet an asset test receive full or partial coverage for premiums and cost sharing and do not face a coverage gap.

Medicare's subsidy amounts

For each Medicare enrollee in a plan (either stand-alone PDP or MA–PD), Medicare provides plans with a subsidy that aims to average 74.5 percent of standard coverage for all types of beneficiaries.¹ That average subsidy takes two forms:

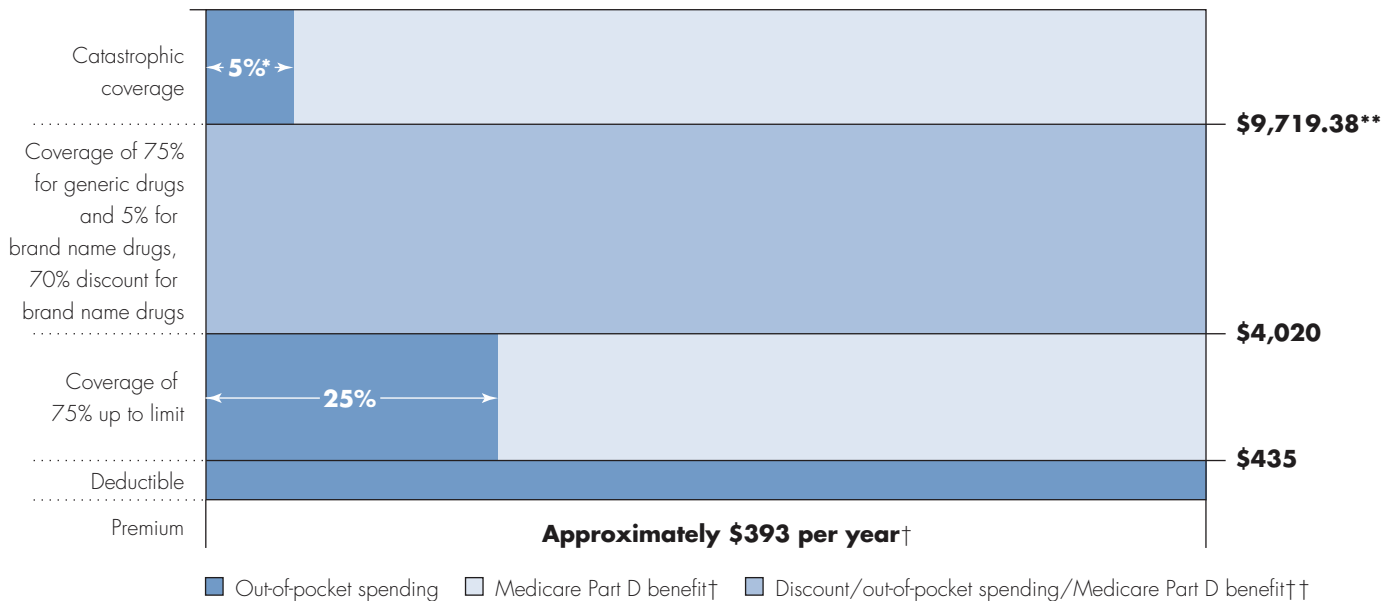
- Direct subsidy—a capitated payment to plans calculated as a share of the adjusted national average of plan bids.
- Individual reinsurance—Medicare subsidizes 80 percent of drug spending above the out-of-pocket threshold. Reinsurance acts as a form of risk adjustment by providing greater federal subsidies for the highest cost enrollees.

*This document does not
reflect proposed legislation
or regulatory actions.*

MEDPAC

425 I Street, NW
Suite 701
Washington, DC 20001
ph: 202-220-3700
fax: 202-220-3759
www.medpac.gov

Figure 1 Standard drug benefit in 2020



Note: Benefit structure applicable to an enrollee who has no supplementary drug coverage.

* Cost sharing above the out-of-pocket (OOP) threshold is the greater of either 5 percent coinsurance or a copay of \$3.60 for generic drugs, or \$8.95 for brand name drugs.

**Equivalent to \$6,350 in OOP spending: \$435 (deductible) + \$896.25 (25% cost sharing on \$3,585) + \$5,018.75 (25% cost sharing for generic drugs, 25% cost sharing for brand name drugs, and 70% manufacturer discount for brand name drugs in the "coverage gap"). The amount of total covered drug spending at which a beneficiary meets the annual OOP threshold depends on the mix of brand name and generic drugs that the individual fills during the coverage gap. The estimated amount of total drug expenses at the annual OOP threshold for 2020 (\$9,719.38) is for an individual not receiving Part D's low-income subsidy (LIS) who has no other sources of supplemental coverage.

† There is a base beneficiary premium of about \$393 per year, which is 25.5% of expected Medicare Part D benefits per person, but the actual premiums that beneficiaries pay vary by plan. Federal subsidies pay for the remainder of covered Part D benefits.

†† In 2020, cost sharing for drugs filled during the coverage gap will be 25% for generic drugs (the remaining 75% will be picked up by the Part D benefit) and about 25% for brand name drugs. The actual cost sharing amount for brand name drugs will depend on the dispensing fee charged by a plan since the 5% covered by the Part D benefit applies to both the ingredient cost and the dispensing fee, while the 70% manufacturer discount applies only to the ingredient cost.

In addition, Medicare establishes symmetric risk corridors separately for each plan to limit a plan's overall losses or profits. Under risk corridors, Medicare limits a plan's potential losses (or gains) by financing some of the higher-than-expected costs (or recouping excessive profits). Also, Medicare pays plans that enroll low-income beneficiaries most of their enrollees' cost sharing and premiums.

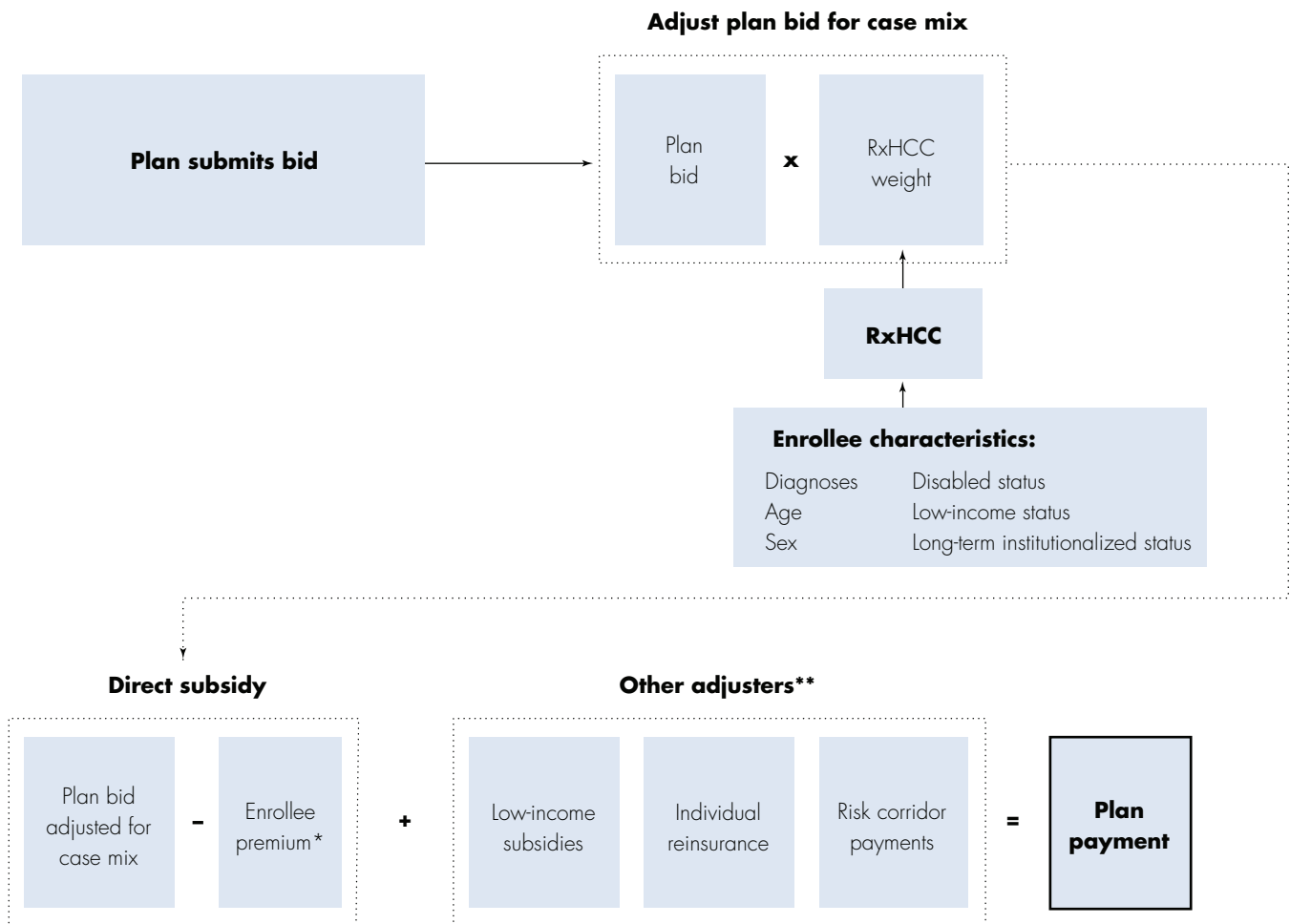
Note that although plans get essentially the same level of direct subsidy per enrollee (modified by risk adjusters), the level of other subsidies differs substantially from plan to plan. Subsidy dollars vary depending on the characteristics of individuals that each plan enrolls (e.g., income and health status), as well as whether a plan's losses or profits trigger provisions of its risk corridors.

Part D replaced Medicaid as the primary source of prescription drug coverage for individuals who are dually eligible for Medicare and Medicaid. However, states continue to help finance the costs of drug coverage for dually eligible beneficiaries by making monthly lump sum payments to Medicare.

Medicare's payments to plans

Each plan submits bids annually to the Centers for Medicare & Medicaid Services (CMS) by the first Monday in June. Those bids should reflect the plan's expected benefit payments plus administrative costs after they deduct expected federal reinsurance subsidies. Plans base their bids on expected costs for a Medicare beneficiary of average health.

Figure 2 Part D payment system



Note: RxHCC (prescription drug hierarchical condition category). The RxHCC is the model that estimates the enrollee risk adjuster. Beginning in 2011, CMS replaced its single model of risk scores with five separate sets of model coefficients for: long-term institutionalized enrollees; aged low-income enrollees; aged non-low-income enrollees; disabled low-income enrollees; and disabled non-low-income enrollees. Prior to 2011, payments on behalf of beneficiaries with low-income and long-term institutionalized status were adjusted using multipliers intended to reflect those individuals' higher levels of drug spending.

* Figure 3 outlines the process for calculating enrollee premiums.

**Plans receive interim prospective payments for individual reinsurance and low-income subsidies that are later reconciled with CMS.

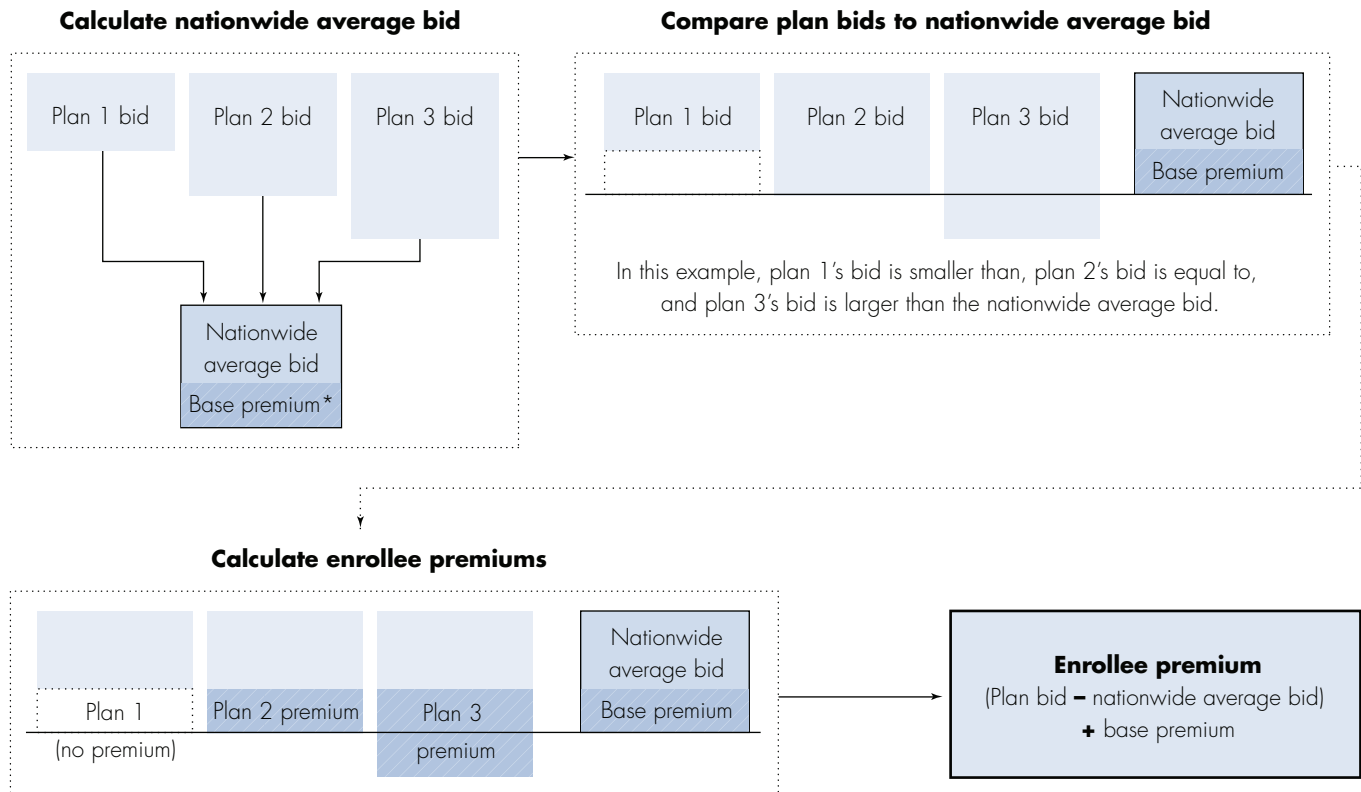
CMS pays plans a monthly prospective payment for each enrollee based on plan bids (the direct subsidy). The plan bid is first adjusted by the enrollee's case mix and other subsidy factors, namely low-income status and long-term institutionalized status (Figure 2). A second adjustment to the plan's approved bid is the subtraction of the enrollee's premium. (See the following section on how premiums are calculated.) CMS also provides plans with interim prospective payment adjustments for individual

reinsurance and low-income subsidies. The agency reconciles actual levels of enrollment, risk factors, levels of incurred allowable drug costs (after rebates and other discounts), reinsurance amounts, and low-income subsidies after the end of each year.

Calculating enrollee premiums

CMS takes plans' standardized bid amounts for basic benefits or the portion of plan bids attributable to basic coverage

Figure 3 Calculating enrollee premiums



Note: *Base premium is a share of the nationwide average bid. It equals the nationwide average times a factor with a numerator of 25.5% and a denominator of 100% minus CMS's estimate of aggregate plan revenues for Part D benefits that they receive through federal individual reinsurance subsidies. Beginning in 2011, Part D has begun collecting additional premiums from higher income enrollees. The extra premium amount is equal to the difference between 35, 50, 65, 80, or 85% and the 25.5% applied to the nationwide average bid adjusted for individual reinsurance.

and calculates the average (Figure 3). The base premium is a share of the nationwide average bid. Plan enrollees pay the base premium plus any difference between their plan's bid and the nationwide average bid. The base premium amount for beneficiaries is \$32.74 in 2020. Enrollees in costlier plans face higher-than-average premiums for standard Part D coverage; similarly, enrollees in less expensive plans pay lower-than-average premiums.⁴

Individuals with modified adjusted gross incomes exceeding \$85,000 (\$170,000 for couples) are subject to higher premiums similar to the income-related premium under Medicare Part B.⁵

Medicare pays all or most of the premium for low-income beneficiaries up to a

regional threshold amount, calculated as an enrollment-weighted average premium for each PDP region. Since enrollees have tended to select or be auto-enrolled in plans with lower premiums, using enrollment weights to calculate the regional thresholds has led to fewer premium-free plans available for low-income beneficiaries. As a result, many individuals have had to change plans or pay the portion of the premium that exceeds the regional threshold to remain in the same plan. To reduce the effects of annual changes in plans that qualify as premium-free, the PPACA changed the benchmark calculation methodology to exclude Medicare Advantage rebates.

Benefit and payment updates

Medicare updates the deductible, benefit limit, and catastrophic threshold amounts in the standard Part D benefit each year. Plan payments are a function of plans' updated bids. The benefit's threshold amounts increase by CMS's estimate of the annual change in drug spending per person. ■

- 1 As a result of changes made by the Patient Protection and Affordable Care Act of 2010 (PPACA), beginning in 2011 the premium subsidy is reduced for higher income beneficiaries. For more information, refer to the section on calculating enrollee premiums.
- 2 The term "true out-of-pocket" refers to a feature of Part D that directs fewer federal subsidy dollars toward enrollees who have supplemental coverage. Specifically, only certain types of spending on behalf of the beneficiary count toward the catastrophic threshold: the beneficiary's own out-of-pocket (OOP) spending; that of a family member or official charity; and supplemental drug coverage provided through qualifying state pharmacy assistance programs or Part D's low-income subsidies. In addition, beginning in 2011, drug spending made on behalf of the beneficiary by AIDS Drug Assistance Program, the Indian Health Service, and the 70 percent discount paid for by pharmaceutical

manufactures for brand name drugs counts toward the OOP threshold. Beneficiaries need to adhere to their plan's formulary, prior authorization, and formulary exceptions processes in order to receive credit for their OOP spending toward the \$6,350 limit.

- 3 PPACA and the 2018 BBA eliminated the coverage gap by: 1) requiring pharmaceutical manufacturers to offer a discount on brand-name drugs filled during the coverage gap (50 percent from 2011 through 2018, 70 percent in 2019 and thereafter), 2) gradually phasing down cost sharing for generic drugs beginning in 2011, 3) phasing down cost sharing for brand name drugs beginning in 2013, and 4) holding down growth in the OOP threshold on true out-of-pocket spending over the 2014 to 2019 period. In 2020, the OOP threshold reverts to the level it would have been had the PPACA not been enacted.
- 4 Beneficiaries (other than those who receive low-income subsidies) who delay enrolling in Part D until after their initial enrollment period and who do not have creditable coverage must also pay a late enrollment penalty similar to that for Part B. Creditable coverage refers to prescription drug benefits through sources such as a former employer that are at least as generous as the standard Part D benefit.
- 5 As a result of changes made under the Medicare Access and CHIP Reauthorization Act of 2015, as of 2018, a higher Part D premium surcharge applies to some beneficiaries who are subject to income-related premiums. Income thresholds for two surcharge tiers (out of five tiers) were lowered and, as a result, more beneficiaries face higher surcharge rates.